Report

of the

Examination of

Little Black Mutual Insurance Company

Stetsonville, Wisconsin

As of December 31, 2003

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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November 19, 2004

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

LITTLE BLACK MUTUAL INSURANCE COMPANY
Stetsonville, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of the company was conducted in 1999 as of December 31, 1998. The current examination covered the intervening period ending December 31, 2003, and included a review of such 2004 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employees' Welfare and Pension Plans
Territory and Plan of Operations
Affiliated Companies
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

II. HISTORY AND PLAN OF OPERATION

The company was originally organized as a town mutual insurance company on June 4, 1889, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Little Black Farmers Mutual Fire Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to Little Black Mutual Insurance Company (LBMIC or the company). Effective January 1, 1998, the company converted from a town mutual insurance company to an assessable mutual insurance company under ch. 611, Wis. Stat.

The conversion plan was approved with limited assessability. The policyholders' assessment liability is limited to one times the annual premium in force at the date of the assessment. Assessments not exceeding the annual premium of the terminated policy may also be levied upon persons whose membership has terminated within four months before the assessment. The Commissioner may revoke the authority for limited assessability, by order, if the Commissioner finds that the methods, practices, or financial condition of the company are such as to endanger the insurance protection of members if the limited assessability were not revoked.

This office's Order that approved the company's conversion to a limited assessable mutual insurer effective January 1, 1998, also requires the company to maintain a minimum surplus of $1 million.

The company is authorized to write insurance throughout the state of Wisconsin. During the period under examination, the company added the counties of Jackson and Adams to its territory and now writes business in 17 contiguous counties in northern Wisconsin. The major products marketed by the company include farmowner's, homeowner's, and commercial multi-peril lines of business. The major products are marketed through 137 agents. As of June 2002, agents receive a 13% flat commission rate on all policies.

In December 2000, the subsidiary North Central Adjusting Company was closed. In April 2002, the subsidiary North Central Insurance Agency was sold to the All-Time Agency.

The following table is a summary of the insurance premiums written by the company in 2003. The growth of the company is discussed in the "Financial Data" section of this report.

Line of Business	Direct Premium	Reinsurance Ceded	Net Premium
Fire	$ 184,876	$ 110,174	$ 74,702
Allied lines	431,963	257,074	174,889
Farmowner's multiple peril	880,765	524,382	356,383
Homeowner's multiple peril	1,067,426	635,515	431,911
Commercial multiple peril	284,995	169,678	115,317
Total all lines	$2,850,025	$1,696,823	$1,153,202

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of seven members divided into three classes. One class is elected at each annual meeting for a three-year term. Officers are elected at the board's annual meeting. The board members currently receive $75 (local), or $100 (out-of-town) for each meeting attended and $0.35 per mile for travel expenses.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Earl Boss Colby, WI	Retired	2005
Donald Boss Abbottsford, WI	Farmer & Operations Supervisor	2005
Pete Wanke Medford, WI	Building Contractor	2005
Vernon Frey Medford, WI	Retired	2006
Donald Koerner Curtiss, WI	Retired	2006
Clarence Schreiner Athens, WI	Logger	2007
Bryce Hinke Medford, WI	Retired	2007

Officers of the Company

The officers serving at the time of this examination are as follows.

Name	Office	2003 Compensation
Pete Wanke	Chairman of the Board	$ 1,500
Michael Schmidmayr	CEO-President	53,476
Donald Boss	Secretary	300
Clarence Schreiner	Treasurer	0
Donald Koerner	Vice Chairman of the Board	0

In January 2004, the company's board of directors removed Michael Schmidmayr from his position as CEO-President. At that time, Anthony Wilke (claims representative) was appointed interim President/General Manager, and Dennis Henke (claims representative) was appointed interim Vice President/Assistant Manager. In February 2004, the board officially named Anthony Wilke as President/General Manager, and Dennis Henke as Vice President/Assistant Manager.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Nominating Committee	**Wage & Salary Committee**
Don Koerner, Chair	Clarence Schreiner, Chair
Don Boss	Bryce Hinke
Earl Boss	Don Boss

IV. REINSURANCE

The company’s reinsurance portfolio and strategy is described below. The examiners’ review revealed there is currently one ceding contract. The contract contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Code.

Reinsurer:	Wisconsin Reinsurance Company
Effective date:	January 1, 2003
Termination provisions:	January 1, 2004, or any subsequent January 1, by either party providing at least 90 days’ advance written notice; unless noted otherwise.

The coverage provided under this treaty is summarized as follows:

1.	Type of contract:	Class A Excess of Loss
	Lines reinsured:	All casualty business
	Company's retention:	$10,000 per loss occurrence
	Coverage:	100% of each and every loss including loss adjusting expense, in excess of the retention of $10,000 in respect to each and every loss occurrence. Subject to maximum policy limits of $1,000,000 per occurrence; $1,000,000 split limits; $5,000 medical payments per person; and $25,000 medical payments per accident.
	Reinsurance premium:	40% of liability premium written
	Termination:	Company shall have the option to select either a cut-off or run-off termination.
2.	Type of contract:	Class B First Surplus
	Lines reinsured:	All property business
	Company's retention:	$400,000 per ceded risk when risk is more than $400,000; 50% on a pro rata basis per ceded risk when the company’s retention is less that or equal to $400,000.
	Coverage:	Up to $800,000 of the loss and loss adjusting expenses on a pro rata basis when the company’s net retention is $400,000 or more in respect to a risk. When the company’s net retention is $400,000 or less in respect to a risk, the company may cede on a pro rata basis up to 50% of such risk.
	Deductible:	10% of loss and loss adjustment expenses otherwise recoverable.

	Reinsurance premium:	100% of the unearned premium applicable to business covered as of the effective date. The company also agrees to pay the pro rata portion of all premiums, fees, and assessments charged by the company corresponding to the amount of risk ceded.
	Ceding commission:	Minimum of 15%, when the loss ratio is 65% or greater. The minimum commission shall be increased by 1% for each 1% decrease in the loss ratio subject to a maximum commission of 35%, when the loss ratio is 45% or less. When the company's cession of risk is greater than \$300,000, the pro rata amount of premiums and losses in excess of \$300,000 will be excluded from additional commission calculations.
3.	Type of contract:	Class B Combination Excess of Loss and Quota Share
	Lines reinsured:	All property business
	Company's retention:	\$25,000 per loss occurrence.
	Coverage:	<u>Part I Quota Share</u>: Reinsurer shall be liable for 50% of each and every net loss on business covered hereunder; The reinsurer shall be liable for 50% of the net outside loss adjusting expenses incurred in conjunction with the settlement of each and every loss on business covered hereunder. The coverage provided under Part I applies before that under Part II and other excess coverages. <u>Part II Excess of Loss</u>: Reinsurer shall indemnify the company for \$50,000 in excess of \$25,000 in respect to each and every risk, every loss occurrence.
	Reinsurance premium:	60% of net property premium written and 60% of the net unearned property premium, less the ceding commission. The rate of each annual period shall be determined by taking the four years' (1998 through 2001) losses incurred by the reinsurer under Part II Excess of Loss divided by the total of the net premiums written for the same period, multiplied by the factor of 125%, plus the quota share recovery rate as set forth in Part I Quota Share. The rate for the first period, being January 1, 2003, to December 31, 2003, shall be calculated using the net premiums written and losses incurred by the reinsurer for the calendar years 1998-2001. Minimum Rate: 5%
	Ceding commission:	Minimum and provisional commission of 25%; a profit commission of 50% of the net profit, if any accruing to the reinsurer during each accounting period defined herein.

4.	Type of contract:	Class C-2 Excess of Loss Second Layer
	Lines reinsured:	All property business
	Company’s retention:	$75,000 in respect to each and every loss occurrence.
	Coverage:	100% of any loss, excluding loss adjusting expense, in excess $75,000 in respect to each and every risk resulting from one loss occurrence. Reinsurer’s limit of liability shall be $325,000 in respect to each and every loss occurrence.
	Reinsurance premium:	1.60% of net premiums written in respect to the business covered hereunder.
5.	Type of contract:	Class D/E Aggregate Stop Loss
	Lines reinsured:	All business written
	Company’s retention:	Subject to a minimum retention of $575,000
	Coverage:	In respect to each annual period, the company shall retain net for its own account an amount of net losses, including loss adjustment expenses, equal to not less than 60% of the company’s net written premium. The reinsurer shall indemnify the company for 100% of the amount, if any, by which the aggregate of the company’s net losses, including loss adjustment expenses, which occur during any annual period exceed an amount equal to 60% of the company’s net premiums written
	Reinsurance premium:	From 7% to 25% of net written premiums based on eight-year loss experience, divided by the total of the net premiums written for that same period multiplied by the factor of 125%. The rate for the current period is 7%. Monthly, within 15 days after the close of each month, the company shall remit the premium due calculated by the above or as agreed by the company and reinsurer. Minimum Rate: 7% of current net written premiums Maximum Rate: 25% of current net written premiums The current annual rate is 7%

V. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2003, annual statement. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

Little Black Mutual Insurance Company
Assets
As of December 31, 2003

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$ 100,000	$ 0	$ 100,000
Stocks:			
Common stocks	770,596	0	770,596
Real estate:			
Occupied by the company	48,649	0	48,649
Cash			
Short-term investments	568,686	0	568,686
Agents' balances or uncollected premiums:			
Premiums and agents' balances in course of collection	8,952	0	8,952
Premiums, agents' balances, and installments booked but deferred and not yet due	409,439	0	409,439
Reinsurance recoverable on loss and loss adjustment expense payments	35,743	0	35,743
Current federal and foreign income tax recoverable and interest thereon	161,122	161,122	0
Electronic data processing equipment and software	18,155	0	18,155
Interest, dividends, and real estate income due and accrued	1,220	0	1,220
Other assets nonadmitted:			
Furniture, equipment, and supplies	6,491	6,491	0
Total Assets	$2,129,053	$167,613	$1,961,440

Little Black Mutual Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 2003

Losses	$ 140,153
Loss adjustment expenses	24,000
Commissions payable, contingent commissions, and other similar charges	75,764
Other expenses (excluding taxes, licenses, and fees)	12,995
Taxes, license and fees (excluding federal and foreign income taxes)	3,736
Unearned premiums	684,477
Advance premium	63,986
Ceded reinsurance premiums payable (net of ceding commissions)	241,180
Total Liabilities	1,246,291
Unassigned funds (surplus)	715,149
Surplus as Regards Policyholders	715,149
Total Liabilities and Surplus	$1,961,440

Little Black Mutual Insurance Company
Summary of Operations
For the Year 2003

Underwriting Income		
Premiums earned		$1,280,862
Deductions:		
Losses incurred	$497,524	
Loss expenses incurred	190,479	
Other underwriting expenses incurred	402,437	
Total underwriting deductions		1,090,440
Net underwriting gain		190,422
Investment Income		
Net investment Income or (loss)	(533)	
Net realized capital gains or losses	0	
Net investment gain or (loss)		(533)
Other Income		
Write-ins for miscellaneous income:		
Policy, Installment, and Other Fees	187,641	
Total other income		187,641
Net income (loss) before dividends to policyholders and before federal and foreign income taxes		377,530
Net Income		$ 377,530

Little Black Mutual Insurance Company
Cash Flow
For the Year 2003

Premiums collected net of reinsurance	$ 970,236		
Net investment income	2,833		
Miscellaneous income	187,641		
Total	1,160,710		
Deduct:			
Benefit and loss related payments		$190,933	
Commissions, expenses paid and Aggregate write-ins for deductions		593,810	
Total		784,743	
Net cash from operations			$ 375,967
Proceeds from investments sold, matured, or repaid:			
Bonds	0		
Total investment proceeds		0	
Cost of investments acquired (long-term only):			
Bonds	100,000		
Real estate	1,181		
Total investments acquired		101,181	
Net cash from investments			(101,181)
Cash provided from financing and miscellaneous sources:			
Other cash provided	(960)		
Total		(960)	
Net cash from financing and miscellaneous sources			(960)
Net change in cash and short-term investments			273,826
Reconciliation			
Cash and short-term investments, December 31, 2001			294,860
Cash and short-term investments, December 31, 2002			$ 568,686

Little Black Mutual Insurance Company
Compulsory and Security Surplus Calculation
December 31, 2003

Assets	$1,961,440	
Less liabilities	1,246,291	
Adjusted surplus		$ 715,149
Annual premium:	1,153,202	
Lines other than accident and health		
Factor	20%	
Total	230,640	
Compulsory surplus (subject to a minimum of $1 million per order for limited assessability)		1,000,000
Compulsory surplus excess (or deficit)		$ (284,851)
Adjusted surplus (from above)		$ 715,149
Security surplus: (140% of compulsory surplus, factor reduced 1% for each $33 million in premium written in excess of $10 million with a minimum factor of 110%)		1,400,000
Security surplus excess (or deficit)		$ (684,851)

The company was deficient in its compulsory and security surplus as of December 31, 2003. In April 2004, Wisconsin Reinsurance Corporation (WRC) released its stock value for year-end 2003 of $51.18 per share, which increased by $21.89 per share over its 2002 value. As a result of this stock value increase the company had an increase in its surplus of $570,016 which was first reported in its June 30, 2004, statement. As of November 2004, the company reported that its surplus was $1,457,621.

Little Black Mutual Insurance Company
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 2003

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	2003	**2002**	**2001**	**2000**	**1999**
Surplus, beginning of year	$ 476,855	$ 450,229	$1,383,764	$1,797,012	$1,466,090
Net income	377,531	311,259	(761,724)	(357,100)	53,144
Net unrealized capital gains or (losses)	(137,141)	(286,663)	(82,749)	253,216	853
Change in net deferred income tax	(35,899)	1,473	132,420		
Change in non-admitted assets	33,803	557	(63,682)	3,710	2,513
Surplus adjustments:					
Prior period adjustment			(157,800)		
Write-ins for gains and (losses) in surplus:					
Net Loss from Subsidiaries				(38,708)	
Adjustment for Receivables from Subsidiaries				(274,412)	274,412
Subsidiaries Adjustment				46	
Surplus, end of year	$ 715,149	$ 476,855	$ 450,229	$1,383,764	$1,797,012

Little Black Mutual Insurance Company
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2003

The company's NAIC Insurance Regulatory Information System (IRIS) results for the period under examination are summarized below.

	Ratio	2003	2002	2001	2000	1999
#1	Gross Premium to Surplus	399%	726%	843%	251%	222%
#2	Net Premium to Surplus	161	98	669*	152	141
#3	Change in Net Writings	147*	-84*	43 *	-2	35*
#4	Surplus Aid to Surplus	21*	36*	0	0	3
#5	Two-Year Overall Operating Ratio	83	117*	122*	107*	107*
#6	Investment Yield	0*	1*	2.3*	2*	1.8*
#7	Change in Surplus	48	-44*	-38*	-8	2
#8	Liabilities to Liquid Assets	58	86	88	73	75
#9	Agents' Balances to Surplus	1	3	6	41*	47*
#10	One-Year Reserve Development to Surplus	-9	-3	-13	11	-99
#11	Two-Year Reserve Development to Surplus	-9	-10	10	-3	-99
#12	Estimated Current Reserve Deficiency to Surplus	-19	27*	52*	-10	-99

Ratio #2, Net Premium to Surplus, had an exceptional value in 2001 due to the decrease in surplus in 2001 and the increase in net premiums written in that year.

Ratio #3, Change in Net Writings, noted exceptional values in 1999 and 2001 through 2003 due to several reasons. The company imposed a moratorium on writing new business in June 2002 and has re-underwritten its entire block of business starting in July of 2002 through October of 2004. The company has nonrenewed approximately 2,831 policies with $1,624,398 in premiums.

Ratio #4, Surplus Aid to Surplus, reported exceptions in 2002 and 2003. These exceptions were due to several factors: 1) changes in the company's quota share reinsurance program in which more risk is being ceded; 2) the reinsurance ceded commissions was negative in 2001 which caused negative surplus aid, while surplus aid was about $174,000 and $147,000 for 2002 and 2003, respectively; the ratio of surplus aid to policyholder's surplus resulted in values of 36% and 21% being reported for the above noted exceptional years.

Ratio #5, Two-Year Overall Operating Ratio, exceptions were noted from 1999 through 2003 which are due to the company having poor underwriting results during this period.

The company has a history of exceptional Investment Yield (Ratio #6) exceptions which are the result of the company's significant investment in non-income producing common stock (51% of invested assets). Another factor causing the low investment yield is about a third of the company's invested assets is in certificates of deposit (20%) and a repurchase agreement (12%) with its bank. The certificates of deposits have interest rates ranging from 2.25% to 2.48%, and the repurchase agreement has an interest rate of .5%.

Ratio #7, Change in Surplus, and ratio #12, Estimated Current Reserve Deficiency to Surplus, exceptions for 2001 and 2002 are from the changes in the company's surplus due to decline in the value of its common stock investments, and poor underwriting results.

Ratio #9, Agents' Balances to Surplus, exceptions for 1999 and 2000 are the result of the Agents' Balances In Course of Collection having balances proportionately large to reported surplus compared to the years 2001 through 2003. The company implemented a moratorium on new business on June 1, 2002.

Growth of Little Black Mutual Insurance Company

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
2003	$1,961,440	$1,246,291	$ 715,149	$ 377,530
2002	2,020,123	1,543,268	476,855	311,259
2001	3,231,744	2,781,515	450,229	(853,185)
2000	3,093,907	1,710,143	1,383,764	(357,100)
1999	3,062,436	1,539,836	1,797,012	$53,144
1998	2,852,996	1,386,906	1,466,090	(315,071)

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
2003	$2,850,025	$1,153,202	$1,280,862	53.7%	18.6%	72.3%
2002	3,461,139	467,823	1,615,359	79.0	10.0	89.0
2001	3,795,049	3,013,268	2,264,153	94.5	34.3	128.8
2000	3,476,405	2,105,539	2,119,846	89.8	29.4	119.2
1999	3,382,076	2,150,738	2,099,111	69.8	29.1	98.9
1998	3,354,907	1,589,089	1,579,479	90.0	34.3	124.3

As indicated by the table above, the company reported net losses in 1998, 2000, and 2001. As a result, surplus declined by 51% during the period under examination.

In 1998, the state experienced widespread windstorms in which many small mutual insurers had high loss ratios. The company experienced a large amount of fire and wind losses during the years 2000 through 2002, which resulted in hitting its stop-loss attachment point with its reinsurer. In December of 2000, the company reported six house fires. On June 11, 2001, a wind and hail storm resulted in 438 claims being reported to the company with total losses paid out of about $1.53 million. On September 2, 2002, the Ladysmith tornado resulted in 81 claims being reported to the company with total losses paid out of about $1.46 million.

The favorable loss ratios for 2002 and 2003 are the result of the company's moratorium on new business and its re-underwriting program. Since 2002, the company has experienced 70% fewer wind claims, and has had a 60% decline in reported claims.

On March 15, 2004, the company started accepting new applications. As of December 15, 2004, the company has opened up all programs for new business with the exception of commercial. As of September 30, 2004, the company has written 111 new policies.

Reconciliation of Surplus per Examination

No adjustments were made to surplus as a result of the examination.

Examination Reclassifications

	Debit	Credit
Taxes, license and fees	$3,938	$
Other expenses		2,847
Amounts withheld for account of others		1,091
Total reclassifications	$3,938	$3,938

VI. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were 30 specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Affiliated Agreements—It is recommended that the new agreements be signed by the appropriate parties and filed with the Commissioner as required by s. Ins 40.04 (2) (d), Wis. Adm. Code.

   Action—Compliance

2. Affiliated Agreements—It is also recommended that the company comply with s. Ins 40.04, Wis. Adm. Code, and file any future changes in agreements or new agreements between affiliates with the Commissioner within 30 days of the agreements' effective date.

   Action—Compliance

3. Affiliated Agreements—It is recommended that the company perform and document a cost-sharing analysis of administrative services being performed on behalf of its affiliates. Pursuant to s. 601.42, Wis. Stat., the cost-sharing analysis shall be filed with the Commissioner within 90 days of adoption of this report.

   Action—Compliance

4. Affiliated Agreements—It is recommended that the company amend the current administrative agreements to reflect the methods used by management when allocating employee time.

   Action—Compliance

5. Affiliated Agreements – It is recommended that on an annual basis the company prepares adequate documentation in support of the administrative services fees being charged to each of the subsidiaries.

   Action—Compliance

6. Holding Company Transactions—It is again recommended that pursuant to s. 601.42, Wis. Stat., the company comply with the holding company reporting requirements of ch. 617, Wis. Stat., and s. Ins 40, Wis. Adm. Code.

   Action—Compliance

7. Holding Company Transactions—It is recommended that the company disclose the aggregate amounts of all affiliated transactions on its annual holding company filings and submits for approval any future loaned funds and/or contributions given to either affiliate, regardless of the materiality threshold, in compliance with ch. Ins 40, Wis. Adm. Code, pursuant to s. 601.42, Wis. Stat.

   Action—Compliance

8. Holding Company Transactions—It is again recommended that LBMIC complete parts 1 and 2 of Schedule Y on all future annual statements as required by the NAIC's Annual Statement Instructions-Property and Casualty.

   Action—Compliance

9. Holding Company Transactions—Pursuant to s. 601.42, Wis. Stat., it is recommended that LBMIC report all transactions between affiliates, whether the affiliates' assets exceed 0.5% of LBMIC's assets or not, in Schedule Y.

   Action—Compliance

10. Holding Company Transactions—It is recommended that the company complete the Notes to Financial Statements as required by the NAIC Annual Statement Instructions - Property and Casualty.

    Action—Compliance

11. Holding Company Transactions—It is recommended that the company make the necessary adjustments at year-end for the accrual of intercompany payables and receivables and report them as required by the NAIC Annual Statement Instructions and Accounting and Procedures Manual for Property and Casualty Insurance Companies.

    Action—Compliance

12. Holding Company Transactions – It is recommended that the company report each subsidiary on a stand-alone basis and discontinue the practice of eliminating intercompany transactions when reporting on a statutory basis.

    Action—Compliance

13. Holding Company Transactions—Pursuant to s. 601.42, Wis. Stat., it is recommended that the company submit the balance sheet and income statement of each subsidiary as a supplement to the annual statement filing.

    Action—Compliance

14. Disaster Recovery Plan—It is recommended that the company periodically reviews and revises its disaster recovery plan and then presents any changes to the board for approval.

    Action—Compliance

15. Accounts and Records—It is recommended that the company comply with s. Ins 6.80 (4), Wis. Adm. Code.

    Action—Compliance

16. Accounts and Records—It is recommended that the company contact its accounting and insurance software vendor(s) in regard to how to retain the general ledger, policy register, and premium information at year-end before the program updates for the new year and document these procedures for future use.

    Action—Compliance

17. Accounts and Records—It is recommended that the company obtain, for its own use, the NAIC Annual Statement Instructions and the NAIC Accounting Practices and Procedures Manual For Property/Casualty Insurance Companies and that such manuals are kept up to date.

    Action—Compliance

18. Invested Assets—It is recommended that the company update its investment plan to cover all aspects of its investment policies and then have it approved by the Board of Directors.

    Action—Compliance

19. Invested Assets—It is also recommended that the board of directors establish an investment committee to oversee the investments of the company.

    Action—Compliance

20. Bonds—It is recommended that the company comply with the filing requirements of the NAIC's Securities Valuation Office.

    Action—Compliance

21. Common Stock—It is recommended that the company include the number of shares on Schedule D for all stock certificates issued in its name.

    Action—Compliance

22. Common Stock—It is recommended that company continue to report the value of common stock in affiliates at zero until such time as the affiliates have a positive net worth.

    Action—Compliance

23. Cash and Invested Cash—It is recommended that the company familiarizes itself with the requirements of ch. 177, Wis. Stat., and in the future correctly report all property subject to those requirements in compliance with s. 177.05 (4), Wis. Stat.

    Action—Noncompliance; see "Summary of Current Examination Results."

24. Cash and Invested Cash—It is also recommended that the company set up a liability for reporting any uncashed checks that are pending escheatment to the state in accordance with the NAIC Annual Statement Instructions.

    Action—Noncompliance; see “Summary of Current Examination Results.”

25. Cash and Invested Cash—It is recommended that the company not maintain more than 10% of its assets in a single issuer, pursuant to s. 620.23 (2) (b), Wis. Stat.

    Action—Compliance

26. Reinsurance Recoverable on Paid Losses—It is recommended that the company net restitution payments against the unpaid loss reserve, as prescribed by the NAIC Accounting Practices and Procedures Manual, for reporting anticipated subrogation or salvage recoveries.

    Action—Compliance

27. Unpaid Loss Adjusting Expense—It is recommended that the company report LAE owed to its subsidiary at year-end on paid losses as a payable to a subsidiary/affiliate on future annual statements.

    Action—Compliance

28. Unpaid Loss Adjustment Expense—It is again recommended that the company develop a method to estimate the expenses necessary to adjust unpaid losses.

    Action—Compliance

29. Unpaid Loss Adjustment Expense—It is recommended that the company establish a system that will assure that the loss adjusting expenses can be captured and recorded in a way that will allow for accurate reporting on Schedule P.

    Action—Compliance

30. Unpaid Loss Adjustment Expense—It is also recommended that the company complete Schedule P in accordance with the NAIC Annual Statement Instructions.

    Action—Compliance

Summary of Current Examination Results

Control Environment

It was noted during the examiners' review of the control questionnaire completed by the company that it does not limit access to its blank checks or drafts to authorized personnel. This internal control weakness was also noted by the company's CPA firm. Management indicated that no blank checks are stored in the vault due to the volume of checks to lock up. At the end of each day, a review is performed to see if checks are missing. If a check is discovered missing, management would issue a stop payment. It is recommended that the company develop a procedure to secure all blank checks and properly maintain control over checks.

It was noted during the examination that the company has an established check signing threshold in which two signatures are required for checks over $10,000. For checks under $10,000, any one of three individuals may sign the check: the underwriter, claims coordinator, or manager. For checks over $10,000, the manager shall be one signer and either the underwriter or claims coordinator may be the second signer. Sample testing of claim payments documented that two checks over the $10,000 authorization level were signed by the underwriter and the claims coordinator, which violates the company policy.

It is recommended that the company comply with its existing procedure in which payments that exceed the $10,000 check authorization level in which two signatures are required, the manager approve and sign the check.

Invested Assets

The examiners reviewed the annual statement general interrogatories section and noted that the company did not fully disclose its repurchase agreement with a local bank. According to the <u>NAIC Accounting Practices and Procedures Manual</u>, SSAP No. 45, the following disclosures shall be made in the financial statements:

a. If the reporting entity has entered into repurchase agreements, its policy for requiring collateral or other security;

b. A description of the securities underlying the agreements, including book values and fair values, maturities, and weighted average interest rates for the following categories: (i) securities subject to reverse repurchase agreements; (ii) securities subject to repurchase agreements;

(iii) securities subject to dollar repurchase agreements; and (iv) securities subject to dollar reverse repurchase agreements; and

c. A description of the terms of reverse repurchase agreements whose amounts are included in borrowed money.

The company made a disclosure for note a, but not b and c. It is recommended that the company disclose its repurchase agreements in the general interrogatories section and make other relevant disclosures in the notes to the financial statements section of the annual statement in accordance with SSAP No. 45 of the NAIC Accounting Practices and Procedures Manual.

It was noted in reviewing the notes to the financial statements, under number 5 of the investment section that for repurchase agreements, the company's policies require a minimum of 100% of the fair value of securities purchased under repurchase agreements to be maintained as collateral.

Under SSAP No. 45, paragraph 8, the reporting entity shall receive as collateral transferred securities having a fair value at least equal to 102% of the purchase price paid by the reporting entity for the securities. If at any time the fair value of the collateral is less than 100% of the purchase price paid by the reporting entity, the counterparty shall be obligated to provide additional collateral the fair value of which, together with fair value of all collateral then held in connection with the transaction, at least equals 102% of the purchase price. It is recommended that the company maintain collateral transferred securities having a fair value at least equal to 102% of the purchase price paid by the reporting entity for the securities pursuant to SSAP No. 45, paragraph 8, of the NAIC Accounting Practices and Procedures Manual.

Cash and Invested Cash

During the review of the cash and invested cash, the examiners discovered that the company is not properly accounting for outstanding checks. The examiners found 41 checks that have been outstanding for five years or more, totaling $2,416. In addition, there were 14 more checks totaling $558 that will become outstanding for longer than five years by December 31, 2004. The examiners inquired with the manager about an unclaimed property report, and it was noted that the company had not filed an unclaimed property report with the State of Wisconsin since the last examination in 1998.

It is again recommended that the company familiarize itself with the requirements of ch. 177, Wis. Stat., and in the future correctly report all property subject to those requirements in compliance with s. 177.05 (4), Wis. Stat. In order to aid in compliance with this recommendation, it is again recommended that the company set up a liability for reporting any uncashed checks that are pending escheatment to the state in accordance with the NAIC Annual Statement Instructions.

Premiums and Agents' Balances in Course of Collection

During the examiners' review of the premiums in course of collection it was noted that the company was unable to produce an aging schedule for its premiums in course of collection balances as of year-end 2003. From the policy balance due report provided by the company it was determined that the company has premiums totaling $423 that were over 90 days past due. Management informed the examiners that with recent programming changes to their software the company is now able to generate an aging schedule. The examiners obtained the most recent report and it showed the aging amount, with the amount over 90 days past due being $553. While the current balance of premiums over 90 days past due and required to be nonadmitted is immaterial, the examiners are concerned that future past due amounts may become material due to the company's resumption of new business activity.

It is recommended that the company properly nonadmit balances greater than 90 days in accordance with the SSAP No. 6.of the NAIC Accounting Practices and Procedures Manual.

EDP Equipment

The examiners reviewed the CPA asset detail for the period ending December 31, 2003. It was noted that the company is depreciating its electronic data processing equipment over a five-year period. Pursuant to SSAP No.16 and No. 79 of the NAIC Accounting Practices and Procedures Manual, EDP equipment and operating system software should be depreciated for a period not to exceed three years using the methods described in SSAP No. 19. It is recommended that the company depreciate its electronic data processing equipment over a period not to exceed three years pursuant SSAP No. 16 and No. 79 of the NAIC Accounting Practices and Procedures Manual.

Commissions Payable

The examiners reviewed the company agent contracts for 2003-2004, and they did not include sufficient detail on the contingent commission agreement with its agents. Subsequent to the examination, the manager provided the 2005 Agent Contract that appears to include language about the contingent commission and the formula the company uses.

Other Expenses

It was noted by the examiners that the company included the fire dues payable amount of $2,847 on the “Other expenses” line of the annual statement. ”Other expenses” should include incurred but unpaid other underwriting and investment expenses, excluding taxes, licenses and fees. See reclassification under “Reconciliation of Surplus per Examination.” It is recommended that the company include fire dues payable on the “Taxes, licenses, and fees” line of the annual statement.

Amounts Withheld for Accounts of Others

The company reported $3,736 for “Taxes, licenses, and fees” on the annual statement. The examiners determined that of this amount, $1,091 is related to employee contributions and other withholdings. Per the NAIC Annual Statement Instructions Property and Casualty, the account “Amounts Withheld for Accounts of Others” should include employees’ FICA and unemployment contributions and other withholdings as well as amounts held in escrow for payment of taxes, insurance, etc., under FHA or other mortgage loans and any other funds that the company holds in a fiduciary capacity. The employer’s portion of federal and state payroll taxes was properly reported as “Taxes, licenses, and fees” on the annual statement. See reclassification under “Reconciliation of Surplus per Examination.” It is recommended that the company properly report its employer withholdings in accordance with the NAIC Annual Statement Instructions Property and Casualty.

VII. CONCLUSION

Under the period of examination, the company reported surplus of $715,149, which is a 51% decline since the previous examination. The company is required to maintain a minimum surplus level of $1,000,000. The company holds 26,040 shares in Wisconsin Reinsurance Corporation (WRC) stock. In April of 2004, WRC released its stock value for year-end 2003 of $51.18 per share, which increased by $21.89 per share over its 2002 value. As a result of the stock value increase as of year-end 2003, the company had an increase in its surplus of $570,016, which was first reported in its June 30, 2004, statement. As of November 2004, the company reported surplus of $1,457,621.

There were two reclassifications made due to the company's failure to comply with properly classifying amounts in accordance with the NAIC Annual Statement Instructions Property and Casualty.

The current examination resulted in ten recommendations, with two of these being repeat recommendations.

In the years 2000 through 2002, the company experienced losses which caused it to hit its stop-loss attachment point with its reinsurer for those years. In December of 2000, the company reported six house fires. On June 11, 2001, a wind and hail storm resulted in 438 claims being reported to the company with total losses paid out of about $1.53 million. On September 2, 2002, the Ladysmith tornado resulted in 81 claims being reported to the company with total losses paid out of about $1.46 million.

The favorable loss ratios for 2002 and 2003 are the result of the company's moratorium on new business and its re-underwriting program. Since 2002, the company has experienced 70% fewer wind claims, and has had a 60% decline in reported claims. The company has re-underwritten its entire block of business; starting in July of 2002 through October of 2004, the company has nonrenewed 2,831 policies having $1,624,398 in premiums.

The company partially lifted its self-imposed moratorium on new business in June of 2003 and began accepting new applications on March 15, 2004. As of December 15, 2004, the company has opened up all programs for new business with the exception of commercial. As of September 30, 2004, the company has written 111 new policies.

VIII. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 26 - Control Environment—It is recommended that the company develop a procedure to secure all blank checks and properly maintain control over checks.

2. Page 26 - Control Environment—It is recommended that the company comply with its existing procedure in which payments that exceed the $10,000 check authorization level in which two signatures are required, the manager approve and sign the check.

3. Page 27 - Invested Assets—It is recommended that the company disclose its repurchase agreements in the general interrogatories section and make other relevant disclosures in the notes to the financial statements section of the annual statement in accordance with SSAP No. 45 of the NAIC Accounting Practices and Procedures Manual.

4. Page 27 - Invested Assets—It is recommended that the company maintain collateral transferred securities having a fair value at least equal to 102% of the purchase price paid by the reporting entity for the securities pursuant to SSAP No. 45, paragraph 8, of the NAIC Accounting Practices and Procedures Manual.

5. Page 28 - Cash and Invested Cash—It is again recommended that the company familiarize itself with the requirements of ch. 177, Wis. Stat., and in the future correctly report all property subject to those requirements in compliance with s. 177.05 (4), Wis. Stat.

6. Page 28 - Cash and Invested Cash—It is again recommended that the company set up a liability for reporting any uncashed checks that are pending escheatment to the state in accordance with the NAIC Annual Statement Instructions.

7. Page 28 - Premiums and Agents' Balances in Course of Collection—It is recommended that the company properly nonadmit balances greater than 90 days in accordance with the SSAP No. 6 of the NAIC Accounting Practices and Procedures Manual.

8. Page 28 - EDP Equipment—It is recommended that the company depreciate its electronic data processing equipment over a period not to exceed three years pursuant SSAP No. 16 and No. 79 of the NAIC Accounting Practices and Procedures Manual.

9. Page 29 - Other Expenses—It is recommended that the company include fire dues payable on the "Taxes, licenses, and fees" line of the annual statement.

10. Page 29 - Amounts Withheld for Account of Others—It is recommended that the company properly report its employer withholdings in accordance with the NAIC Annual Statement Instructions Property and Casualty.

IX. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
Karl Albert	Insurance Examiner

Respectfully submitted,

DuWayne A Kottwitz
Examiner-in-Charge